

VZCZCXRO2935

RR RUEHAG RUEHAST RUEHDA RUEHDBU RUEHDF RUEHFL RUEHIK RUEHKW RUEHLA
RUEHLN RUEHLZ RUEHNP RUEHPOD RUEHROV RUEHRSK RUEHSR RUEHVK RUEHYG
DE RUEHTL #0144/01 1421432
ZNR UUUUU ZZH
R 221432Z MAY 09
FM AMEMBASSY TALLINN
TO RUEHC/SECSTATE WASHDC 1150
INFO RUEHZL/EUROPEAN POLITICAL COLLECTIVE
RUEATRS/DEPT OF TREASURY WASHDC
RUCPDOG/DEPT OF COMMERCE WASHDC

UNCLAS SECTION 01 OF 02 TALLINN 000144

DEPARTMENT FOR EEB/CBA, EUR/ERA AND EUR/NB
TREASURY FOR DAVID WRIGHT
COMMERCE FOR ITA

SIPDIS
SENSITIVE

E.O. 12958: N/A

TAGS: [PGOV](#) [EFIN](#) [ECON](#) [EINV](#) [EN](#)

SUBJECT: IMF CALLS ESTONIAN ECONOMY 'RESILIENT' AS
GOVERNMENT SHAKE-UP AIMS TO ACHIEVE BUDGET AGREEMENT

REF: A) Tallinn 57
B) Tallinn 78

TALLINN 00000144 001.2 OF 002

¶1. (SBU) SUMMARY: PM Ansip's May 21 dismissal of junior coalition members - including his Minister of Finance - demonstrate how contentious the recent debates over budget cuts have been. Estonia's first quarter GDP in 2009 fell 15 percent over the same period in 2008. The GOE needs to make painful budget cuts by year's end in order to meet Maastricht criteria and stay on track for Eurozone accession in ¶2011. By dismissing the Social Democrats, Ansip has consolidated his political base and removed an impediment to agreement on the budget. While these political machinations are the talk of the town, there is some good news: the IMF, the Bank of Estonia (BOE) and Swedbank have all endorsed the GOE's focus on improving fiscal balance and investor confidence. END SUMMARY.

¶2. (SBU) In mid-May, the Estonian Statistics Board released data indicating GDP declined by 15.6 percent in the first quarter (Q1) of 2009 compared to the same period last year, and by 6.5 percent since Q4 of 2008. (Note: The Bank of Estonia had forecast 2009 GDP contraction of only 8.9 percent in February. (Ref A) BOE analysts now believe the trend will slow in the second half of 2009 as export markets stabilize. End note.) Rising unemployment remains a significant concern, reaching 11.5 percent nationwide, and exceeding 14 percent in Estonia's predominantly Russian-speaking northeast region.

¶3. (SBU) These grim statistics catalyzed already tense discussions among the three-party coalition that makes up the government. In addition to falling GDP, the GOE has also been debating a new labor law that could contribute to even higher unemployment. With coalition partners deadlocked, PM Andrus Ansip took on May 21 the long- anticipated step of dismissing his three cabinet members from the Social Democratic Party, including his Minister of Finance Ivari Padar (Septel).

Tightrope Walking to the Euro

¶4. (SBU) The GOE is counting on strict adherence to a 3 percent budget deficit and Euro accession "as soon

as possible" to propel Estonia's long-term economic recovery. The Prime Minister himself is driving Estonian efforts to join the Euro by the beginning of 2011. Since Estonia's accession to the EU in 2004, the GOE has set - and then missed - several target dates for entry into the euro, primarily because of higher than average inflation. Projected deflation of 0.5 percent this year, however, has removed this from the GOE's list of concerns.

15. (SBU) The GOE has already cut the FY09 budget once this year (by 7 percent), but coalition partners (particularly the now-dismissed Social Democrats) have struggled to agree on additional cuts necessary to stay within Maastricht limits, as well as a new labor law that could result in higher unemployment. Ansip has made clear that he is willing to accept short-term pain (reduced spending and job losses) to keep Estonia's budget in check. His approach has been largely endorsed by the IMF, the Bank of Estonia and Swedbank (the largest bank in Estonia) in recent days. Despite months of speculation about possible devaluation of the kroon, an IMF team in Tallinn May 14-18 called Estonia's currency board system "successful" and "resilient" to the ongoing global economic crisis. They lauded Estonia's "prudent fiscal policies for most of the decade..." but noted that the budget is now the major policy challenge for 2009 and beyond. Our contacts at the BOE and Swedbank both agreed that budget issues are more pressing than unemployment concerns right now. If the GOE cannot make sufficient cuts to stay within the Maastricht deficit target (three percent of GDP), the BOE believes that access to credit markets will dry up in 2010 and Estonia could be forced to seek IMF help. Both Swedbank and our BOE contacts have noted

TALLINN 00000144 002 OF 002

positively that the private sector and households have made a "remarkable" adjustment to the current climate, shedding debt and cutting costs faster than expected.

16. (SBU) COMMENT: By dismissing his smallest and least supportive coalition partner (Social Democrats), PM Ansip has demonstrated how far he is willing to go to keep the GOE budget on target. Without the Social Democrats, however, Ansip's Reform Party and remaining coalition partner Isamaa and Respublica Liit (IRL) must either bring a new party into the coalition or find at least one opposition (or independent) MP to vote in favor of the proposed budget cuts. (Note: Reform and IRL control 50 seats in the 101-member Parliament. Negotiations among political parties are ongoing. End Note.) END COMMENT.

DECKER